

Assembly Bill No. 846

CHAPTER 145

An act to amend Section 10251 of the Corporations Code, and to amend Sections 1063, 10531, 17351, and 21524 of, to add Chapter 3 (commencing with Section 16320) to Part 4 of Division 9 of, and to repeal Chapter 3 (commencing with Section 16300) of Part 4 of Division 9 of, the Probate Code, relating to the Uniform Principal and Income Act.

[Approved by Governor July 21, 1999. Filed with
Secretary of State July 22, 1999.]

LEGISLATIVE COUNSEL'S DIGEST

AB 846, Ackerman. Uniform Principal and Income Act.

Existing law, the Revised Uniform Principal and Income Act, requires a trust to be administered, as specified, with due regard to the respective interests of defined income beneficiaries and defined remainder beneficiaries.

This bill would repeal these provisions and enact the Uniform Principal and Income Act.

The people of the State of California do enact as follows:

SECTION 1. Section 10251 of the Corporations Code is amended to read:

10251. (a) "Educational institution," as used in this section, means any nonprofit corporation organized under Chapter 4 (commencing with Section 94400) or Chapter 7 (commencing with Section 94700) of Part 59 of the Education Code or organized under Part 1 (commencing with Section 9000) of this division in effect on December 31, 1979, and designated on or after January 1, 1980, as a nonprofit public benefit corporation, or organized for charitable or eleemosynary purposes under Part 2 (commencing with Section 5110) of this division, or Part 3 (commencing with Section 10200) of this division in effect on December 31, 1979, and designated on or after January 1, 1980, as a nonprofit public benefit corporation for the purpose of establishing, conducting or maintaining an institution offering courses beyond high school and issuing or conferring a diploma or for the purpose of offering or conducting private school instruction on the high school or elementary school level and any charitable trust organized for such purpose or purposes. "Educational institution," as used in this section, also means the University of California, the California State University, the California Community Colleges, and any auxiliary organization, as

defined in Section 89901 of the Education Code, established for the purpose of receiving gifts, property and funds to be used for the benefit of a state college.

(b) It shall be lawful for any educational institution to become a member of a nonprofit corporation incorporated under the laws of any state for the purpose of maintaining a common trust fund or similar common fund in which nonprofit organizations may commingle their funds and property for investment and to invest any and all of its funds, whenever and however acquired, in the common fund or funds; provided that, in the case of funds or property held as fiduciary, the investment is not prohibited by the wording of the will, deed, or other instrument creating the fiduciary relationship.

(c) An educational institution electing to invest in a common fund or funds under this section may elect to receive distributions from each fund in an amount not to exceed for each fiscal year the greater of the income, as determined under the Uniform Principal and Income Act, Chapter 3 (commencing with Section 16320) of Part 4 of Division 9 of the Probate Code, accrued on its interest in the fund or 10 percent of the value of its interest in the fund as of the last day of its next preceding fiscal year. The educational institution may expend the distribution or distributions for any lawful purpose notwithstanding any general or special law characterizing the distribution, or any part thereof, as principal or income; provided that, in the case of funds or property invested as fiduciary, the expenditure is not prohibited by the wording of the will, deed, or other instrument creating the fiduciary relationship. No such prohibition of expenditure shall be deemed to exist solely because a will, deed, or other instrument, whether executed or in effect before or after the effective date of this section, directs or authorizes the use of only the "income," or "interest," or "dividends" or "rents, issues or profits," or contains words of similar import.

(d) The Corporate Securities Law of 1968 shall not apply to the creation, administration, or termination of common trust funds authorized under this section, or to participation therein.

(e) This section shall become operative on January 1, 1997.

SEC. 2. Section 1063 of the Probate Code is amended to read:

1063. (a) In all accounts, there shall be an additional schedule showing the estimated market value of the assets on hand as of the end of the accounting period, and a schedule of the estimated market value of the assets on hand as of the beginning of the accounting period for all accounts subsequent to the initial account. The requirement of an estimated value of real estate, a closely held business, or other assets without a ready market, may be satisfied by a good faith estimate by the fiduciary.

(b) If there were purchases or other changes in the form of assets occurring during the period of the account, there shall be a schedule showing these transactions. However, no reporting is required for

transfers between cash or accounts in a financial institution or money market mutual funds as defined in subdivision (d) of Section 8901.

(c) If an estate of a decedent or a trust will be distributed to an income beneficiary, there shall be a schedule showing an allocation of receipts and disbursements between principal and income.

(d) If there is specifically devised property, there shall be an additional schedule accounting for income, disbursements, and proceeds of sale pursuant to Section 12002 and subdivision (a) of Section 16340.

(e) If any interest has been paid or is to be paid under Section 12003, 12004, or 12005, or subdivision (b) of Section 16340, there shall be a schedule showing the calculation of the interest.

(f) If the accounting contemplates a proposed distribution, there shall be a schedule setting forth the proposed distribution, including the allocation of income required under Section 12006. If the distribution requires an allocation between trusts, the allocation shall be set forth on the schedule, unless the allocation is to be made by a trustee after receipt of the assets. If the distribution requires valuation of assets as of the date of distribution, the schedule shall set forth the fair market value of those assets.

(g) If, at the end of the accounting period, there are liabilities of the estate or trust, except current or future periodic payments, including rent, salaries, utilities, or other recurring expenses, there shall be a schedule showing all of the following:

(1) All liabilities which are a lien on estate or trust assets.

(2) Taxes due but unpaid as shown on filed returns or assessments received subsequent to filing of returns.

(3) All notes payable.

(4) Any judgments for which the estate or trust is liable.

(5) Any other material liability.

SEC. 3. Section 10531 of the Probate Code is amended to read:

10531. (a) The personal representative has the power to manage and control property of the estate, including making allocations and determinations under the Uniform Principal and Income Act, Chapter 3 (commencing with Section 16320) of Part 4 of Division 9. Except as provided in subdivision (b), the personal representative may exercise this power without giving notice of proposed action under Chapter 4 (commencing with Section 10580).

(b) The personal representative shall comply with the requirements of Chapter 4 (commencing with Section 10580) in any case where a provision of Chapter 3 (commencing with Section 10500) governing the exercise of a specific power so requires.

SEC. 4. Chapter 3 (commencing with Section 16300) of Part 4 of Division 9 of the Probate Code is repealed.

SEC. 5. Chapter 3 (commencing with Section 16320) is added to Part 4 of Division 9 of the Probate Code, to read:

CHAPTER 3. UNIFORM PRINCIPAL AND INCOME ACT

Article 1. Short Title and Definitions

16320. This chapter may be cited as the Uniform Principal and Income Act.

16321. The definitions in this article govern the construction of this chapter.

16322. “Accounting period” means a calendar year unless another 12-month period is selected by a fiduciary. The term includes a portion of a calendar year or other 12-month period that begins when an income interest begins or ends when an income interest ends.

16323. “Fiduciary” means a personal representative or a trustee.

16324. “Income” means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in Article 5.1 (commencing with Section 16350), 5.2 (commencing with Section 16355), or 5.3 (commencing with Section 16360).

16325. “Income beneficiary” means a person to whom net income of a trust is or may be payable.

16326. “Income interest” means the right of an income beneficiary to receive all or part of net income, whether the trust requires it to be distributed or authorizes it to be distributed in the trustee’s discretion.

16327. “Mandatory income interest” means the right of an income beneficiary to receive net income that the trust requires the fiduciary to distribute.

16328. “Net income” means the total receipts allocated to income during an accounting period minus the disbursements made from income during the accounting period, plus or minus transfers under this chapter to or from income during the accounting period.

Article 2. General Provisions and Fiduciary Duties

16335. (a) In allocating receipts and disbursements to or between principal and income, and with respect to any other matter within the scope of this chapter, a fiduciary:

(1) Shall administer a trust or decedent’s estate in accordance with the trust or the will, even if there is a different provision in this chapter.

(2) May administer a trust or decedent’s estate by the exercise of a discretionary power of administration given to the fiduciary by the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this chapter, and no inference that the fiduciary has improperly exercised the discretion

arises from the fact that the fiduciary has made an allocation contrary to a provision of this chapter.

(3) Shall administer a trust or decedent's estate in accordance with this chapter if the trust or the will does not contain a different provision or does not give the fiduciary a discretionary power of administration.

(4) Shall add a receipt or charge a disbursement to principal to the extent that the trust or the will and this chapter do not provide a rule for allocating the receipt or disbursement to or between principal and income.

(b) In exercising a discretionary power of administration regarding a matter within the scope of this chapter, whether granted by a trust, a will, or this chapter, including the trustee's power to adjust under subdivision (a) of Section 16336, the fiduciary shall administer the trust or decedent's estate impartially, except to the extent that the trust or the will expresses an intention that the fiduciary shall or may favor one or more of the beneficiaries. The exercise of discretion in accordance with this chapter is presumed to be fair and reasonable to all beneficiaries.

16336. (a) Subject to subdivision (b), a trustee may make an adjustment between principal and income to the extent the trustee considers necessary if all of the following conditions are satisfied:

(1) The trustee invests and manages trust assets under the prudent investor rule.

(2) The trust describes the amount that shall or may be distributed to a beneficiary by referring to the trust's income.

(3) The trustee determines, after applying the rules in subdivision (a) of Section 16335, and considering any power the trustee may have under the trust to invade principal or accumulate income, that the trustee is unable to comply with subdivision (b) of Section 16335.

(b) A trustee may not make an adjustment between principal and income in any of the following circumstances:

(1) Where it would diminish the income interest in a trust (A) that requires all of the income to be paid at least annually to a spouse and (B) for which, if the trustee did not have the power to make the adjustment, an estate tax or gift tax marital deduction would be allowed, in whole or in part.

(2) Where it would reduce the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion.

(3) Where it would change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets.

(4) Where it would be made from any amount that is permanently set aside for charitable purposes under a will or trust, unless both income and principal are so set aside.

(5) Where possessing or exercising the power to make an adjustment would cause an individual to be treated as the owner of



all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment.

(6) Where possessing or exercising the power to make an adjustment would cause all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment.

(7) Where the trustee is a beneficiary of the trust.

(c) Notwithstanding Section 15620, if paragraph (5), (6), or (7) of subdivision (b) applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the trust.

(d) A trustee may release the entire power conferred by subdivision (a) or may release only the power to adjust from income to principal or the power to adjust from principal to income in either of the following circumstances:

(1) If the trustee is uncertain about whether possessing or exercising the power will cause a result described in paragraphs (1) to (6), inclusive, of subdivision (b).

(2) If the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subdivision (b).

(e) A release under subdivision (d) may be permanent or for a specified period, including a period measured by the life of an individual.

(f) A trust that limits the power of a trustee to make an adjustment between principal and income does not affect the application of this section unless it is clear from the trust that it is intended to deny the trustee the power of adjustment provided by subdivision (a).

(g) In deciding whether and to what extent to exercise the power to make adjustments under this section, the trustee may consider, but is not limited to, any of the following:

(1) The nature, purpose, and expected duration of the trust.

(2) The intent of the settlor.

(3) The identity and circumstances of the beneficiaries.

(4) The needs for liquidity, regularity of income, and preservation and appreciation of capital.

(5) The assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor.

(6) The net amount allocated to income under other statutes and the increase or decrease in the value of the principal assets, which the



trustee may estimate as to assets for which market values are not readily available.

(7) Whether and to what extent the trust gives the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.

(8) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation.

(9) The anticipated tax consequences of an adjustment.

(h) Nothing in this section or in this chapter is intended to create or imply a duty to make an adjustment, and a trustee is not liable for not considering whether to make an adjustment or for choosing not to make an adjustment.

16337. (a) A trustee may give a notice of proposed action regarding a matter governed by this chapter as provided in this section. For the purpose of this section, a proposed action includes a course of action and a decision not to take action.

(b) The trustee shall mail notice of the proposed action to all adult beneficiaries who are receiving, or are entitled to receive, income under the trust or to receive a distribution of principal if the trust were terminated at the time the notice is given.

(c) Notice of proposed action need not be given to any person who consents in writing to the proposed action. The consent may be executed at any time before or after the proposed action is taken.

(d) The notice of proposed action shall state that it is given pursuant to this section and shall state all of the following:

(1) The name and mailing address of the trustee.

(2) The name and telephone number of a person who may be contacted for additional information.

(3) A description of the action proposed to be taken and an explanation of the reasons for the action.

(4) The time within which objections to the proposed action can be made, which shall be at least 30 days from the mailing of the notice of proposed action.

(5) The date on or after which the proposed action may be taken or is effective.

(e) A beneficiary may object to the proposed action by mailing a written objection to the trustee at the address stated in the notice of proposed action within the time period specified in the notice of proposed action.

(f) A trustee is not liable to a beneficiary for an action regarding a matter governed by this chapter if the trustee does not receive a written objection to the proposed action from the beneficiary within the applicable period and the other requirements of this section are satisfied. If no beneficiary entitled to notice objects under this



section, the trustee is not liable to any current or future beneficiary with respect to the proposed action.

(g) If the trustee receives a written objection within the applicable period, either the trustee or a beneficiary may petition the court to have the proposed action taken as proposed, taken with modifications, or denied. In the proceeding, a beneficiary objecting to the proposed action has the burden of proving that the trustee's proposed action should not be taken. A beneficiary who has not objected is not estopped from opposing the proposed action in the proceeding. If the trustee decides not to implement the proposed action, the trustee shall notify the beneficiaries of the decision not to take the action and the reasons for the decision, and the trustee's decision not to implement the proposed action does not itself give rise to liability to any current or future beneficiary. A beneficiary may petition the court to have the action taken, and has the burden of proving that it should be taken.

16338. In a proceeding with respect to a trustee's exercise or nonexercise of the power to make an adjustment under Section 16336, the sole remedy is to direct, deny, or revise an adjustment between principal and income.

16339. This chapter applies to every trust or decedent's estate existing on or after January 1, 2000, except as otherwise expressly provided in the trust or will or in this chapter.

Article 3. Decedent's Estate or Terminating Income Interest

16340. After the decedent's death, in the case of a decedent's estate, or after an income interest in a trust ends, the following rules apply:

(a) If property is specifically given to a beneficiary, by will or trust, the fiduciary of the estate or of the terminating income interest shall distribute the net income and principal receipts to the beneficiary who is to receive the property, subject to the following rules:

(1) The net income and principal receipts from the specifically given property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether the amounts accrued or became due before, on, or after the decedent's death or an income interest in a trust ends, and by making a reasonable provision for amounts the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

(2) The fiduciary may not reduce income and principal receipts from the specifically given property on account of a payment described in Section 16370 or 16371, to the extent that the will, the trust, or Section 12002 requires payment from other property or to the extent that the fiduciary recovers the payment from a third person.



(b) The fiduciary shall distribute to a beneficiary who receives a pecuniary amount, whether outright or in trust, the interest or any other amount provided by the will, the trust, or Chapter 8 (commencing with Section 12000) of Part 10 of Division 7, from the remaining net income determined under subdivision (c) or from principal to the extent that net income is insufficient.

(c) The fiduciary shall determine the remaining net income of the decedent's estate or terminating income interest as provided in this chapter and by doing the following:

(1) Including in net income all income from property used to discharge liabilities.

(2) Paying from income or principal, in the fiduciary's discretion, fees of attorneys, accountants, and fiduciaries, court costs and other expenses of administration, and interest on death taxes, except that the fiduciary may pay these expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of these expenses from income will not cause the reduction or loss of the deduction.

(3) Paying from principal all other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances, and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the trust, or Division 10 (commencing with Section 20100).

(d) After distributions required by subdivision (b), the fiduciary shall distribute the remaining net income determined under subdivision (c) in the manner provided in Section 16341 to all other beneficiaries.

(e) For purposes of this section, a reference in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7 to the date of the testator's death means the date of the settlor's death or of the occurrence of some other event on which the distributee's right to receive the gift depends.

16341. (a) Each beneficiary described in subdivision (d) of Section 16340 is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution dates and without reducing the values by any unpaid principal obligations.

(b) If a fiduciary does not distribute all of the collected but undistributed net income to each beneficiary as of a distribution date, the fiduciary shall maintain appropriate records showing the interest of each beneficiary in that net income.

(c) The distribution date for purposes of this section may be the date as of which the fiduciary calculates the value of the assets if that

date is reasonably near the date on which assets are actually distributed.

Article 4. Apportionment at Beginning and End of Income Interest

16345. (a) An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

(b) An asset becomes subject to a trust at the following times:

(1) In the case of an asset that is transferred to a trust during the transferor's life, on the date it is transferred to the trust.

(2) In the case of an asset that becomes subject to a trust by reason of a will, even if there is an intervening period of administration of the testator's estate, on the date of the testator's death.

(3) In the case of an asset that is transferred to a fiduciary by a third party because of the individual's death, on the date of the individual's death.

(c) An asset becomes subject to a successive income interest on the day after the preceding income interest ends, as determined under subdivision (d), even if there is an intervening period of administration to wind up the preceding income interest.

(d) An income interest ends on the day before an income beneficiary dies, or another terminating event occurs, or on the last day of a period during which there is no beneficiary to whom a trustee may distribute income.

16346. (a) A trustee shall allocate an income receipt or disbursement other than one to which subdivision (a) of Section 16340 applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

(b) A trustee shall allocate an income receipt or disbursement to income if its due date occurs on or after the date on which a decedent dies or an income interest begins and it is a periodic due date. An income receipt or disbursement shall be treated as accruing from day to day if its due date is not periodic or it has no due date. The portion of the receipt or disbursement accruing before the date on which a decedent dies or an income interest begins shall be allocated to principal and the balance shall be allocated to income.

(c) An item of income or an obligation is due on the date the payer is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this chapter. Distributions to shareholders or other owners from an entity to which Section 16350 applies are deemed to be due on the date fixed by the entity for determining who is entitled to receive the distribution or, if no date



is fixed, on the declaration date for the distribution. A due date is periodic for receipts or disbursements that must be paid at regular intervals under a lease or an obligation to pay interest or if an entity customarily makes distributions at regular intervals.

16347. (a) For the purposes of this section, “undistributed income” means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal by the trust.

(b) Except as provided in subdivision (c), on the date when a mandatory income interest ends, the trustee shall pay to a mandatory income beneficiary who survives that date, or to the estate of a deceased mandatory income beneficiary whose death causes the interest to end, the beneficiary’s share of the undistributed income that is not disposed of under the trust.

(c) If immediately before the income interest ends, the beneficiary under subdivision (b) has an unqualified power to revoke more than 5 percent of the trust, the undistributed income from the portion of the trust that may be revoked shall be added to principal.

(d) When a trustee’s obligation to pay a fixed annuity or a fixed fraction of the value of the trust’s assets ends, the trustee shall prorate the final payment.

Article 5.1. Allocation of Receipts During Administration of Trust: Receipts From Entities

16350. (a) For the purposes of this section, “entity” means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a trustee has an interest other than a trust or decedent’s estate to which Section 16351 applies, a business or activity to which Section 16352 applies, or an asset-backed security to which Section 16367 applies.

(b) Except as otherwise provided in this section, a trustee shall allocate to income money received from an entity.

(c) A trustee shall allocate to principal the following receipts from an entity:

(1) Property other than money.

(2) Money received in one distribution or a series of related distributions in exchange for part or all of a trust’s interest in the entity.

(3) Money received in total or partial liquidation of the entity.

(4) Money received from an entity that is a regulated investment company or a real estate investment trust if the money distributed is a capital gain dividend for federal income tax purposes.

(d) For purposes of paragraph (3) of subdivision (c):

(1) Money is received in partial liquidation (A) to the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation, or (B) if the total amount of money and property received in a distribution or series of related distributions is greater than 20 percent of the entity's gross assets, as shown by the entity's yearend financial statements immediately preceding the initial receipt.

(2) Money is not received in partial liquidation, nor may it be taken into account under clause (B) of paragraph (1), to the extent that it does not exceed the amount of income tax that a trustee or beneficiary is required to pay on taxable income of the entity that distributes the money.

(e) A trustee may rely on a statement made by an entity about the source or character of a distribution if the statement is made at or near the time of distribution by the entity's board of directors or other person or group of persons authorized to exercise powers to pay money or transfer property comparable to those of a corporation's board of directors.

16351. A trustee shall allocate to income an amount received as a distribution of income from a trust or a decedent's estate (other than an interest in an investment entity) in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from the trust or estate.

16352. (a) If a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or other activity instead of accounting for it as part of the trust's general accounting records, the trustee may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

(b) A trustee who accounts separately for a business or other activity may determine the extent to which its net cash receipts must be retained for working capital, the acquisition or replacement of fixed assets, and its other reasonably foreseeable needs, and the extent to which the remaining net cash receipts are accounted for as principal or income in the trust's general accounting records. If a trustee sells assets of the business or other activity, other than in the ordinary course of the business or other activity, the trustee shall account for the net amount received as principal in the trust's general accounting records to the extent the trustee determines that the amount received is no longer required in the conduct of the business or other activity.

(c) Businesses and other activities for which a trustee may maintain separate accounting records include the following:

(1) Retail, manufacturing, service, and other traditional business activities.



- (2) Farming.
- (3) Raising and selling livestock and other animals.
- (4) Managing rental properties.
- (5) Extracting minerals and other natural resources.
- (6) Timber operations.
- (7) Activities to which Section 16366 applies.

Article 5.2. Allocation of Receipts During Administration of
Trust: Receipts Not Normally Apportioned

16355. A trustee shall allocate to principal:

(a) To the extent not allocated to income under this chapter, assets received from a transferor during the transferor's lifetime, a decedent's estate, a trust with a terminating income interest, or a payer under a contract naming the trust or its trustee as beneficiary.

(b) Subject to any contrary rules in this article and in Articles 5.1 (commencing with Section 16350) and 5.3 (commencing with Section 16360), money or other property received from the sale, exchange, liquidation, or change in form of a principal asset, including realized profit.

(c) Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph (7) of subdivision (a) of Section 16371 or for other reasons to the extent not based on the loss of income.

(d) Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income.

(e) Net income received in an accounting period during which there is no beneficiary to whom a trustee may or must distribute income.

(f) Other receipts allocated to principal as provided in Article 5.3 (commencing with Section 16360).

16356. Unless the trustee accounts for receipts from rental property pursuant to Section 16352, the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, shall be added to principal and held subject to the terms of the lease, and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

16357. (a) An amount received as interest, whether determined at a fixed, variable, or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for



prepaying principal, shall be allocated to income without any provision for amortization of premium.

(b) An amount received from the sale, redemption, or other disposition of an obligation to pay money to the trustee more than one year after it is purchased or acquired by the trustee, including an obligation whose purchase price, or its value when it is otherwise acquired, is less than its value at maturity, shall be allocated to principal. If the obligation matures within one year after it is purchased or acquired by the trustee, an amount received in excess of its purchase price, or its value when it is otherwise acquired, shall be allocated to income.

(c) This section does not apply to an obligation to which Section 16361, 16362, 16363, 16364, 16366, or 16367 applies.

16358. (a) Except as otherwise provided in subdivision (b), a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of, or loss of title to a trust asset. The trustee shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

(b) A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income, or, subject to Section 16352, loss of profits from a business.

(c) This section does not apply to a contract to which Section 16361 applies.

Article 5.3. Allocation of Receipts During Administration of Trust: Receipts Normally Apportioned

16360. (a) If a trustee determines that an allocation between principal and income required by Section 16361, 16362, 16363, 16364, or 16367 is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subdivision (b) of Section 16336 applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subdivision (c) of Section 16336 and may be released for the reasons and in the manner provided in subdivisions (d) and (e) of Section 16336.

(b) An allocation is presumed to be insubstantial in either of the following cases:

(1) Where the amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent.



(2) Where the value of the asset producing the receipt for which the allocation would be made is less than 10 percent of the total value of the trust's assets at the beginning of the accounting period.

(c) Nothing in this section imposes a duty on the trustee to make an allocation under this section, and the trustee is not liable for failure to make an allocation under this section.

16361. (a) In this section, "payment" means a payment that a trustee may receive over a fixed number of years or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer's general assets or from a separate fund created by the payer, including a private or commercial annuity, an individual retirement account, and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

(b) To the extent that a payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.

(c) If no part of a payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subdivision, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

(d) If, to obtain an estate tax marital deduction for a trust, a trustee shall allocate more of a payment to income than provided by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

(e) This section does not apply to payments to which Section 16362 applies.

16362. (a) In this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and right to receive payments under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to Section 16361, resources subject to Section 16363, timber subject to Section 16364, an activity subject to Section 16366, an asset subject to Section 16367, or any asset for which the trustee establishes a reserve for depreciation under Section 16372.



(b) A trustee shall allocate to income 10 percent of the receipts from a liquidating asset and the balance to principal.

16363. (a) To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) If received as a nominal bonus, nominal delay rental, or nominal annual rent on a lease, a receipt shall be allocated to income.

(2) If received from a production payment, a receipt shall be allocated to income if and to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance shall be allocated to principal.

(3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income.

(4) If an amount is received from a working interest or any other interest in mineral or other natural resources not described in paragraph (1), (2), or (3), 90 percent of the net amount received shall be allocated to principal and the balance to income.

(b) An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

(c) This chapter applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust.

16364. (a) To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts as follows:

(1) To income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the timber during the accounting periods in which a beneficiary has a mandatory income interest.

(2) To principal to the extent that the amount of timber removed from the land exceeds the rate of growth of the timber or the net receipts are from the sale of standing timber.

(3) To or between income and principal if the net receipts are from the lease of timberland or from a contract to cut timber from land owned by a trust, by determining the amount of timber removed from the land under the lease or contract and applying the rules in paragraphs (1) and (2).

(4) To principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to paragraph (1), (2), or (3).

(b) In determining net receipts to be allocated under subdivision (a), a trustee shall deduct and transfer to principal a reasonable amount for depletion.



(c) This chapter applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

16365. (a) If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under Section 16336 and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income or convert it into productive property or exercise the power under subdivision (a) of Section 16336 within a reasonable time. The trustee may decide which action or combination of actions to take.

(b) In cases not governed by subdivision (a), proceeds from the sale or other disposition of a trust asset are principal without regard to the amount of income the asset produces during any accounting period.

16366. (a) In this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments that gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates, or other market indicator for an asset or a group of assets.

(b) To the extent that a trustee does not account under Section 16352 for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

(c) If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust, or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

16367. (a) In this section, “asset-backed security” means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than



interest or current return. The term does not include an asset to which Section 16350 or 16361 applies.

(b) If a trust receives a payment from interest or other current return and from other proceeds of the collateral financial assets, the trustee shall allocate to income the portion of the payment which the payer identifies as being from interest or other current return and shall allocate the balance of the payment to principal.

(c) If a trust receives one or more payments in exchange for the trust's entire interest in an asset-backed security in one accounting period, the trustee shall allocate the payments to principal. If a payment is one of a series of payments that will result in the liquidation of the trust's interest in the security over more than one accounting period, the trustee shall allocate 10 percent of the payment to income and the balance to principal.

Article 6. Allocation of Disbursements During Administration of Trust

16370. A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (2) or (3) of subdivision (c) of Section 16340 applies:

(a) Except as otherwise ordered by the court, one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee.

(b) Except as otherwise ordered by the court, one-half of all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests.

(c) All of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest, ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a proceeding or other matter that concerns primarily the income interest.

(d) All recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

16371. (a) A trustee shall make the following disbursements from principal:

(1) Except as otherwise ordered by the court, the remaining one-half of the disbursements described in subdivisions (a) and (b) of Section 16370.

(2) Except as otherwise ordered by the court, all of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale.

(3) Payments on the principal of a trust debt.

(4) Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property.

(5) Premiums paid on a policy of insurance not described in subdivision (d) of Section 16370 of which the trust is the owner and beneficiary.

(6) Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust.

(7) Disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties, and defending claims based on environmental matters.

(b) If a principal asset is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the trustee shall transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the obligation.

16372. (a) For purposes of this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more than one year.

(b) A trustee may transfer from income to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation, under generally accepted accounting principles, but may not transfer any amount for depreciation under this section in any of the following circumstances:

(1) As to the portion of real property used or available for use by a beneficiary as a residence or of tangible personal property held or made available for the personal use or enjoyment of a beneficiary.

(2) During the administration of a decedent’s estate.

(3) If the trustee is accounting under Section 16352 for the business or activity in which the asset is used.

(c) An amount transferred from income to principal need not be held as a separate fund.

16373. (a) If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.



(b) Principal disbursements to which subdivision (a) applies include the following, but only to the extent that the trustee has not been and does not expect to be reimbursed by a third party:

(1) An amount chargeable to income but paid from principal because it is unusually large, including extraordinary repairs.

(2) A capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments.

(3) Disbursements made to prepare property for rental, including tenant allowances, leasehold improvements, and broker's commissions.

(4) Periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments.

(5) Disbursements described in paragraph (7) of subdivision (a) of Section 16371.

(c) If the asset whose ownership gives rise to the disbursements becomes subject to a successive income interest after an income interest ends, a trustee may continue to transfer amounts from income to principal as provided in subdivision (a).

16374. (a) A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

(b) A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

(c) A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately as follows:

(1) From income to the extent that receipts from the entity are allocated to income.

(2) From principal to the extent that both of the following apply:

(A) Receipts from the entity are allocated to principal.

(B) The trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (A).

(d) For purposes of this section, receipts allocated to principal or income shall be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax.

16375. (a) A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from any of the following:

(1) Elections and decisions, other than those described in subdivision (b), that the fiduciary makes from time to time regarding tax matters.

(2) An income tax or any other tax that is imposed upon the fiduciary or a beneficiary as a result of a transaction involving or a distribution from the estate or trust.

(3) The ownership by a decedent's estate or trust of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust, or a beneficiary.

(b) If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by a decedent's estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement must equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced must be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

SEC. 6. Section 17351 of the Probate Code is amended to read:

17351. (a) If any of the trustees of a trust described in Section 17350 is a trust company, the trust shall be removed from continuing court jurisdiction as provided in this section. Within six months after the initial funding of the trust, the trustee shall give a notice of removal of the trust from continuing court jurisdiction to each beneficiary. Notice of removal shall be sent by registered or certified mail or by first-class mail, but notice sent by first-class mail is effective only if an acknowledgment of receipt of notice is signed by the beneficiary and returned to the trustee.

(b) The notice of removal of the trust from continuing court jurisdiction shall contain the following:

(1) A statement that as of January 1, 1983, the law was changed to remove the necessity for continuing court jurisdiction over the trust.

(2) A statement that Section 17200 of the Probate Code gives any beneficiary the right to petition a court to determine important matters relating to the administration of the trust.

(3) A copy of the text of Sections 17200 and 17201.

(4) A statement that each income beneficiary, as defined in Section 16325, is entitled to an annual statement of the principal and income receipts and disbursements of the trust and that any other beneficiary is entitled to such information upon written request to the trustee.

(5) The name and location of the court in the county in which it is appropriate to file a petition pursuant to Section 17200, the name and location of the court that had jurisdiction over the administration of the decedent's estate, and a statement that it is appropriate to file a petition pursuant to Section 17200 with either court.



(c) The trustee shall file with the court that had jurisdiction over the administration of the decedent's estate proof of giving notice under this section within seven months after the initial funding of the trust.

SEC. 7. Section 21524 of the Probate Code is amended to read:

21524. If a marital deduction gift is made in trust, in addition to the other provisions of this chapter, each of the following provisions also applies to the marital deduction trust:

(a) The transferor's spouse is the only beneficiary of income or principal of the marital deduction property as long as the spouse is alive. Nothing in this subdivision precludes exercise by the transferor's spouse of a power of appointment included in a trust that qualifies as a general power of appointment marital deduction trust.

(b) Subject to subdivision (d), the transferor's spouse is entitled to all of the income of the marital deduction property not less frequently than annually, as long as the spouse is alive.

(c) The transferor's spouse has the right to require that the trustee of the trust make unproductive marital deduction property productive or to convert it into productive property within a reasonable time.

(d) Notwithstanding Section 16347, in the case of qualified terminable interest property under Section 2056(b)(7) or Section 2523(f) of the Internal Revenue Code, on termination of the interest of the transferor's spouse in the trust all of the remaining accrued or undistributed income shall pass to the estate of the transferor's spouse, unless the instrument provides a different disposition that qualifies for the marital deduction.

